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UNCLAS SECTION 01 OF 02 ZAGREB 000497

SENSITIVE
SIPDIS

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E.O. 12958: N/A

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SUBJECT: RESPONSE TO REQUEST FOR INFORMATION ON CROATIA'S
ENERGY STRATEGY (C-RE9-00787)

REF: STATE 76695

¶1. (SBU) Summary. Progress on Croatia's LNG terminal is excruciatingly slow, with LNG project staff at INA, Croatia's largest shareholder in the project, sitting idle waiting for the final investment decision to be made. As Croatia's domestic gas production slowly declines, its need for new sources of energy will become acute if demand projections are accurate. Croatia's national energy strategy, developed last year but yet to be passed by parliament, reportedly will not include a new nuclear plant which many had advocated. Croatia has begun work on projects to connect with Nabucco or South Stream to the north, and the Trans Adriatic Pipeline to the south, hoping to hedge their bets on future gas supplies. But in the near term, Croatia's dependence on Russia for energy will steadily increase. End Summary.

¶2. (SBU) The Croatian government energy investment strategy, developed in late 2008 with the final draft released in January, has not yet been adopted by the Croatian parliament. The reasons for the long delay are unclear, although the internal debate over the role of nuclear power, a central point of contention, appears to be over. Officials of the energy department of the Ministry of Economy told us that a Croatian nuclear plant was now off the table, at least until ¶2015. The rest of the draft strategy calls for a combination of coal fired power, natural gas, and renewables to satisfy Croatia's spiking demand.

¶3. (SBU) Croatia has not taken a prominent role in the large scale regional infrastructure projects under discussion, such as South Stream or Nabucco. Croatia has been more active on some of the smaller scale existing and potential gas transmission plans under development such as the Trans Adriatic Pipeline and the Ionian Adriatic Pipeline. The latter pipeline Croatia hopes to connect to via a planned pipeline south through Dalmatia (Note: Dalmatia is currently powered largely by hydro plants with little or no gas transmission infrastructure). On Nabucco and South Stream, the government has not spoken out strongly in favor of one project over another since neither in its current form would pass through Croatian territory. Instead, Croatia is trying to position itself to benefit from whichever project comes to fruition. They recently began construction of a gas interconnector with Hungary that will terminate at a point in Hungary where both the Nabucco and South Stream lines would pass.

¶4. (SBU) While the economics and politics of Nabucco and South Stream play themselves out, Croatia is also working to diversify its energy supply, albeit slowly. Croatia only recently achieved one milestone towards realization of its LNG terminal on the island of Krk by successfully negotiating the structure of the Croatian portion of the Adria LNG consortium. The national oil company INA and the national

power company HEP will have the largest participation, with the gas transmission company Plinacro taking a tiny percentage as well. According to an LNG expert at INA, the environmental assessment has been completed but it will still be months before the structure of the Adria LNG consortium can be finalized and a final investment decision made. She indicated that there was still some risk that in the current economic environment the consortium could decide not to move forward.

¶5. (SBU) Recognizing that they will at least partially depend on Russia for their energy needs for a long time, Croatia tries to keep cordial relations with both Russian energy companies and the Russian government. Our INA contact told us this dependency is creeping upward as Croatia's domestic production slowly declines, making the need for LNG increasingly urgent. She also told us Gasprom has refused to increase supplies to Croatia after 2012 within the current long-term gas contract. This will leave Croatia with a significant gap in supply if they are unable to realize the LNG terminal or other sources.

¶6. (SBU) Potential new sources of gas are few. Key among the new partners is Qatar, which Croatia foresees as the future major supplier for the LNG terminal. Qatar has been receptive, but has been frank with the Croatians that it cannot realistically provide new supplies of gas until at least 2012. With LNG terminal construction to take several years, this might not be a problem, but only if Croatia can negotiate contracts relatively soon. According to our contacts at INA, this is largely Croatia's own fault, since the LNG project could have progressed much more quickly and contracts with Qatar could have been signed years ago. Croatia also has attempted to forge a stronger relationship

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with Algeria as a potential hedge against future gas crises. They would like to have contracts in place with Algeria and Italy such that Algeria would transport gas to Italy through existing infrastructure and Italy would then release an equal quantity of gas to Croatia from its Adriatic fields.

¶7. (SBU) Comment: In all likelihood, the LNG terminal project will go forward, but progress is excruciatingly slow. The staff within the office at INA set up to work on the project is largely idle, waiting for the key decisions to be taken to finally lift the project off the ground. The government's draft energy investment strategy, released late last year, was a smart and realistic examination of options for the future diversification of energy supplies. Now, eight months later, with the strategy yet to be finalized and the country in the middle of an economic crisis, the plan seems much less realistic. That leaves Croatia increasingly dependent on gas from Russia, a situation Russia is no doubt keenly aware of.

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